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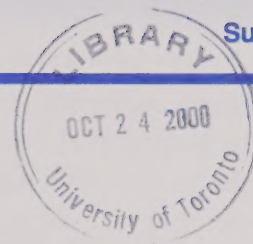
PENSION NEWS

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Teachers' Pension Plan Board
Conseil du régime de retraite des enseignantes et des enseignants

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How we invest in stocks and how we came to own shares of Bre-X



Our investment performance is measured by the fund's rate of return. So winning on individual investments is important, but how well

the overall fund performs is critical.

In the aftermath of the Bre-X fraud, many members have shown an interest in understanding how we choose investments. In this issue of Pension News we explain the methods we use to invest in stocks, why they work and how we came to own shares of the now infamous Bre-X Minerals.

We buy stocks in two ways: 1. We buy a basket of stocks that mimics the market index. 2. We select individual stocks we think are undervalued.

1. How we mimic the market

The TSE 300 index contains shares of Canada's 300 major public corporations. We buy the market by investing proportionately in every stock listed on the TSE (Toronto Stock Exchange) 300 index to its weighted capitalization in the index. For instance, if Bell Canada Enterprises (BCE) makes up 5.02% of the index, then 5.02% of our Canadian index portfolio contains BCE shares.

Investing this way may seem like a 'no brainer,' but successful portfolio managers can earn additional value. Through astute trading, our index portfolio has generated returns in excess of the index for the past four years. Last year our

Canadian index portfolio produced a rate of return of 28.4%, beating the index by 10 basis points.

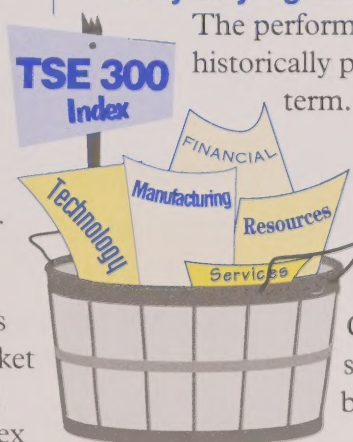
Replicating the index is a cost-effective way to invest. Because we are buying all the stocks in the index, we do not require analysis of individual stocks, and thus we need fewer people to manage the portfolio.

Our strategy of replicating the index is a significant reason why our investment expenses are low. Last year we spent 8.6 cents for every \$100 of invested assets, while the average pension plan spent 16 cents and the average equity mutual fund \$2.

Why buying the basket of stocks works

The performance of index funds has historically proven effective over the long term. According to the December 1996 edition of the Financial Post Survey of Mutual Funds, the annualized return of the index exceeded the average Canadian mutual fund in seven of the last 10 years, before management fees.

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How we invest in stocks and how we came to own shares of Bre-X

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The chart below shows the growth of the index during the past 30 years. The average annual rate of return for the last 20 years was 13.76%. Eliminating the effect of inflation, this means that if you took \$1,000 in 1977 and invested it in the TSE 300 index, today you would have \$13,187.

"The return on an individual stock is less important than the return on the portfolio"

Claude Lamoureux, President and CEO

Replicating the index is also one of the primary ways we buy stocks on the American, European and Far East markets.

Canadian index funds at a glance *

Portfolio: Core Domestic

Investments: \$13.8 billion

Contains: 300 companies listed on the TSE 300

Rate of return: 28.4%

Benchmark: 28.3% (TSE 300)

Goal: Match the performance of the index

2. Selecting individual stocks

We also select shares of individual companies we consider to be undervalued. We analyze each company's financial performance, operations, industry position, management quality, long-term business plan, board structure and board independence.

The most important principle behind investment approach is

that we look for value. This work is done by staff teams of portfolio managers and stock analysts.

It can take several years for the market to recognize the value of a company's shares, hence the patience of our long-term approach. When gains materialize, we do take profits, although we may not necessarily sell our entire position in a company.

In 1996, the actively managed Canadian stock portfolio produced a 31.5% rate of return, compared with the benchmark of 28.3%.

Canadian actively managed equities at a glance *

Portfolio: Equities

Investments: \$2.7 billion

Contains: about 40 companies

Rate of return: 31.5%

Benchmark: 28.3% (TSE 300)

Goal: Create value in excess of TSE 300

* at December 31, 1996

Asset mix is critical

Buying the stocks listed on the index, or selecting the individual stocks we think will be winners are important to the performance of the fund. However, the dominant determinate of a fund's long-term performance is its asset mix.



"More than 80% of value creation is derived from establishing a long-term asset mix appropriate to the liabilities of the fund," says Leo de



Research and Economics

Leo de Bever (left) meets with some of his staff.
(Left to right: Jane Safrance, Zev Frishman, Barbara Zvan)

Bever, the pension plan's vice-president of Research and Economics. The fund's asset mix is 75% equities (stocks, private companies and real estate) and 25% fixed income (government debentures, treasury bills, mortgages).

Highlights of our 1996 investment performance

- Total assets grew by \$9 billion to almost \$51 billion.
- The rate of return on investments was 19%.
- The rate of return for the last four years averaged 14.6%, one of the best results of any pension plan or balanced mutual fund.
- The fund achieved a surplus of \$1.2 billion, a welcome change from the deficiency of \$3.6 billion in 1990 when the board was created.

Role of the Board of Directors

The board of directors approves and monitors each of our investment programs. For index funds the investment program is straightforward—

if a stock is in the index, we buy it.

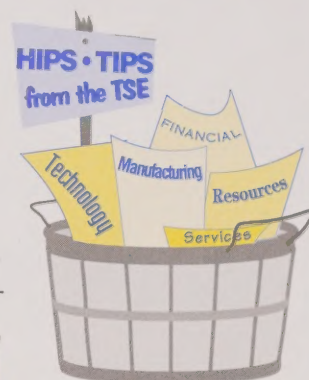
The nine directors oversee the operations of the Teachers' Pension Plan Board. Four

of the directors are appointed by the OTF and four by the Ontario government. The ninth member, the chair, is jointly appointed.

Here's how you can buy a basket of stocks

If you're interested in long-term investing and like the idea of index funds, you can buy units of HIPs or TIPs. These trade like stocks on the Toronto Stock Exchange

but are representative of a basket of stocks—HIPs is the TSE 100 index, and TIPs is the TSE 35 index. If you're interested in buying units of HIPs or TIPs, contact a stock broker. ■



EFFECT OF BRE-X FRAUD

Our investment in Bre-X was made through our index fund after the Toronto Stock Exchange added it to the TSE 300 index.

- Bre-X was added to the TSE 300 index in November 1996.
- We purchased 4.4 million shares at a cost of about \$100 million, or less than 0.2% of the total fund.
- The loss amounts to 20 cents out of \$100.
- We have asked the TSE to review the process used to add stocks to the index, and we are re-evaluating our own processes as well.




You Asked Us

Q. *I recently married for the first time. Does my new wife automatically qualify for a survivor pension?*

S. Zimic, Gull Lake

A. No, not automatically. You must apply to us within 90 days of your marriage. If you miss this deadline, you will have to pass a medical examination before receiving approval for a survivor pension.

To provide the survivor pension, your current pension will be actuarially reduced based on the ages of both you and your spouse, and the amount you wish to provide them with (from 50% to 75% of your pension).

For those remarrying, the rules are different. We'll review all the marriage after retirement rules in greater detail in an upcoming issue of *Pension News*. 

PENSION NEWS

Pension News is published for pensioners by the Communications Department of the Teachers' Pension Plan Board.

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Benchmarks measure Fund's performance

The benchmark is a market or industry standard. Each portfolio is measured against a benchmark that tracks the average results of the market in which we invest. To the extent we exceed market averages, we can identify the value we have added to each portfolio. The benchmarks used include:


- TSE 300 for Canadian equities
- Standard & Poor (S&P) 500 for U.S. equities
- EAFE index for equities in Europe, Australia and the Far East
- Frank Russell Canada Property Index for real estate
- Scotia McLeod Canada bond index for bonds

We measure the performance of the total fund against a composite benchmark that aggregates the returns for each portfolio benchmark, using our asset mix policy weights.

Last year the pension plan achieved a 19% rate of return, beating the composite benchmark of 18.1%.



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